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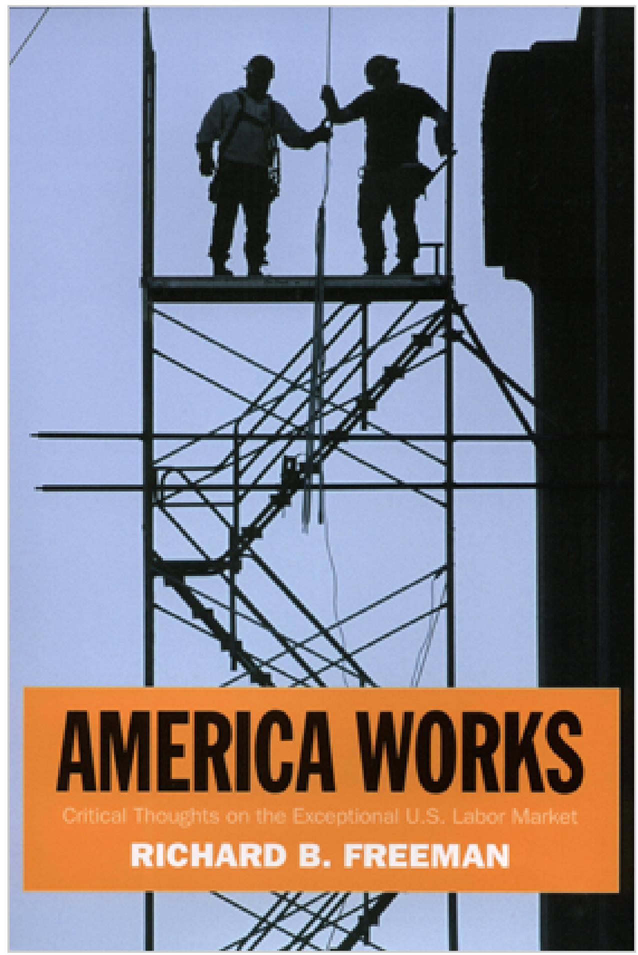
May the invisible hand be with you: Can the U.S. market-driven labor system do better without reducing productivity and growth?

America Works: Critical Thoughts on the Exceptional U.S. Labor Market. By Richard B. Freeman. New York: Russell Sage Foundation, 2008, 191 pp., $15.95 paperback.



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In *America Works*, Richard B. Freeman takes us on a five-star tour of the United States labor market, laying out what is right and what is wrong with it in an entertaining and thoughtful manner. Freeman begins the book with a comparison between the United States and other advanced countries regarding how they determine pay, regulate the labor market, and provide social support to their workers. However, before getting into a "war of the models," the reader has to understand how the U.S. labor market works, and Freeman does a splendid job explaining the American job system in the first two chapters. The American labor system has less institutional regulation than other major advanced countries have and provides U.S. workers with lower safety nets to deal with disability, unemployment, and health problems. The United States also relies more than other advanced countries (e.g., France and Canada) on decentralized wage setting to determine pay. There's no question that the U.S. market-driven labor system diverges greatly from those in countries that make considerable use of collective bargaining (such as Canada, the European Union, and Japan, to name a few), but these differences have given the American labor market an extraordinary reputation. Freeman says that the U.S. job market is exceptional because it does not restrict the ability of businesses to make decisions (and therefore it does not restrict economic freedom), because it promotes mobility and job security, and because it has fewer labor regulations (relying basically on the country's court system).

Freeman cites the statement "You're fired"—Donald Trump's famous catchphrase from the TV show *The Apprentice*—to illustrate the freedom of firms, and the song "Take This Job and Shove It" to depict the mobility of workers and the presence of job security in the American labor market. Americans are known for their extraordinary mobility, not just across firms, but also across states. Market-driven economies do better than institution-driven systems in periods of great economic variability because markets are more flexible than institutions. This flexibility explains, in part, why, during the 1990s and the first decade of the 2000s, the U.S. labor system delivered high employment and an increase in productivity, in comparison to the labor systems of the country's European counterparts. The main source of high employment during that time came from women and immigrants. On the other side, productivity increases came from investing in education and in research and development, from skilled immigrants (engineers, scientists), and from automation of the economy, which experienced a shift from low-productive agriculture and less skilled manufacturing jobs to higher-value-added manufacturing jobs and knowledge-intensive jobs. The question that arises here is, Why has the American labor system failed to distribute the gains achieved from economic growth and rising productivity to workers in the form of rising real wages and benefits in the past couple of decades?

In *America Works*, the author describes how inequality—defined as the differences in earnings across economic activities—"stole the cookie from the jar." Institutionally driven wage systems tie productivity growth and wages together more tightly than does a market-driven labor system, so it is at this point that the reader starts wondering whether the most market-driven labor system fell short of the invisible-hand model in ways that institutions might correct. Why *are* earnings and income so unequally distributed in the United States? One reason is that earnings among unionized workers, whose wages are set by collective bargaining, and the earnings of public-sector workers, whose wages are set by governments or through collective bargaining, are less dispersed than the earnings of otherwise comparable workers in the nonunion private sector and, as is common knowledge, union membership has been declining steadily for years. Freeman estimates that the decline of unions accounted for perhaps 20 percent of the rise in inequality in the country. Another institutional force that affects inequality is the minimum wage, an issue currently being debated both at the national and state level. Among the variety of proposals suggested by the author are two kinds: those aimed at helping workers and firms, such as increasing spending on research and development, implementing financial incentives for students in science and engineering, and increasing profit sharing and employee stock ownership; and those aimed at improving "property rights" of workers—for example, offering union membership by industry or geographic area rather than by company and granting tax breaks to companies offering stock options to workers proportionate to their income.

The book uses charts to visualize the U.S. labor market's position in relation to the labor markets of other economies, both advanced and otherwise. Freeman makes use of data from the Current Population Survey (CPS) to discuss earnings and labor force participation rates. He highlights the fact that the CPS earnings survey understates the increase in earnings for high-income earners; in other words, people who earn more than $150,000, whether it be $1 million or $10 million, are classified simply as earning more than $150,000, rather than by the actual amount that they earned. Freeman also mentions that the earnings data fail to include stock options, which constitute a major part of the compensation package for top executives. Although I am generally sympathetic to both the analysis and the conclusions presented in *America Works*, I have to admit that I found the chapter which includes all the proposals lacking in detail.

So, should you read this book? The answer is yes: chapter after chapter, the author brings the reader along for a ride into the mystery of why earnings haven't gone up when productivity and real wages are supposed to rise together in a market economy—and in trying to solve this dilemma, *America Works* provides a compelling plan for how we can ensure that markets will work better for all Americans.